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TAGS: ECON MA
SUBJECT: IMF ON MADAGASCAR: ECONOMIC OUTLOOK BLEAK, BUT
GOVERNMENT CAN SUSTAIN ITSELF

¶1. (SBU) Summary: According to the IMF resident representative in Madagascar, GDP growth for 2009 is likely to fall between negative 0.5 and negative 1 percent. Because of the transition government's prudent fiscal policy and declining world prices, inflation remains under control. The exchange rate also has remained fairly stable during the past six months, and the banking sector remains sound. For the first eight months of 2009, total fiscal revenues reached 74 percent of target levels. The government has continued to pay wages and debt service, but has drastically cut investment spending. As a result of this fiscal austerity, the overall deficit is low. Although pressure will mount on public finances due to the global recession and the need to increase social spending, the government can continue to sustain its basic operations for the foreseeable future. However, the compounded effects of poor agricultural policies, a negative investment climate, the potential loss of AGOA trade benefits, and limited public investment paint a far bleaker economic picture for 2010. End summary.

GDP Growth Projections Slightly Negative

¶2. (SBU) The American Chamber of Commerce in Madagascar (Amcham) featured guest speaker Pierre van den Boogaerde, the resident representative of the International Monetary Fund (IMF), at its monthly member breakfast Sept 10. He explained that Madagascar's poverty reduction and growth facility (PRGF) with the IMF had expired in July 2007, without being completed. Although the IMF has ceased all formal engagement with the transition authorities, it continues to provide advice at the working level to contacts at the central bank and finance ministry. According to van den Boogaerde, GDP growth for 2009 is likely to range from negative 0.5 to negative 1 percent. Although the industrial sector has been hard hit by the combined international financial and local political crises, it makes up a fairly small portion of the overall Malagasy economy, approximately 12 percent. Large negatives in the secondary sector have been offset by strong growth in the primary sector (especially mining), which makes up 30 percent of GDP. The agricultural sector performed well this year due to benign weather conditions and incentives provided by the former government last year in the form of price guarantees, fertilizer, and seeds to plant counter-season rice. Furthermore, although the secondary sector overall has performed poorly this year, certain segments, particularly telecommunications, pharmaceuticals, and the brewery, have done well. The services sector has been impacted mainly by a move of workers from the formal to

the informal sector, evinced by a growth in second hand clothing imports and street vendors. Before the political crisis, Madagascar was poised to be among the eight fastest-growing economies of the world in 2009, with 7 percent growth. Van den Boogaerde suggested that substantial growth was possible in the rice, cotton, cacao, vanilla, and lima beans (pois du cap) sectors if the proper policies were applied.

Low Inflation

¶3. (SBU) Because of the transition government's prudent fiscal policy and declining world prices, inflation has been contained. Year on year, inflation was 8.2 percent in July and could be lower in August. Since March, prices have fallen month to month, but are expected to rise toward the end of 2009. This trend is partially due to tight fiscal policy, but also to a worldwide trend of lower fuel and food prices this year, compared with the same period in 2008.

Exchange Rate Stabilized, but Overvalued

¶4. (SBU) The exchange rate has remained fairly stable during the past six months, despite the crisis, although according to van den Boogaerde, it remains overvalued by around 30 percent, reducing the competitiveness of Malagasy exports. He asserted that a competitive rate was in place from 2004 - 2005, which was driven up by a huge shock of foreign direct investment in mining in 2006 - 2008. Although the value of the real exchange rate has fallen somewhat since the last quarter of 2008, it has not reached its 2005 level.

Banking Sector Stable

¶5. (SBU) Van den Boogaerde lauded the performance of the central bank during the political crisis, noting that the interbank currency market did not break down even one day and the normal flow of currency circulation (60 billion ariary, equivalent to USD 31 million) was never interrupted. Although the central bank did intervene slightly during the second and third quarters by selling foreign currency and buying ariary to maintain its value, overall, the bank has applied a prudent monetary policy (and is now purchasing foreign currency) he said. The level of official foreign reserves remains adequate, according to van den Boogaerde. The main problem with the banking sector now is that commercial banks are reluctant to lend and thus have excess liquidity. The rate of credit expansion, particularly for trade credits, is low. Some banks that lent heavily to the ousted president's company, Tiko group, have been impacted by non-performing loans, as the company has been looted, including of the rice and oil that guaranteed those loans.

Low Government Deficit

¶6. (SBU) For the first eight months of 2009, total fiscal revenues reached 74 percent of target levels, with tax revenues at 84 percent and customs revenues at 62 percent of target levels. Customs revenues are down because imports have declined by around 30 percent compared with the previous year. Although exports are also down by 18 percent, the current account balance is improving due to the larger reduction in imports. The government has continued to pay wages, debt service, and some value added tax reimbursements, but has drastically cut investment spending. Public expenditures had reached only 30 percent of the original budgeted amount as of September 4, with 56 percent spent on administrative costs (including buying 4-by-4 vehicles for mutinous military officers, joked van den Boogaerde), 26 percent on infrastructure, and only 17 percent on social costs, leaving hospitals without proper support such as access to HIV drugs. As a result of this fiscal austerity, the overall deficit is low. The government has not increased borrowing; as a result treasury bill rates had declined to an

average of 5.05 percent as of September 4.

The Government Can Sustain Itself

¶7. (SBU) Van den Boogaerde explained that, although pressure will mount on the public finances due to the recession and the need to increase social spending, including to support the reopening of schools in late September int he face of reduced donor funding, the government can continue to sustain its basic operations indefinitely. Average monthly fiscal revenue reached 143 billion ariary (USD 74.4 million) during the first eight months of 2009. According to van den Boogaerde, the government needs approximately 40 billion ariary (USD 20.8 million) to cover wages and 20 billion ariary (USD 10.4 million) to pay foreign debt per month. Even accounting for the fact that the government typically takes in two-thirds of its revenue during the first half of the year and only one-third during the latter half, it should still be able to sustain basic operations for the foreseeable future.

Negative Outlook

¶8. (SBU) Although the government can continue limping along, the compounded effects of poor agricultural policies under the new government, a negative investment climate, the potential loss of AGOA trade benefits, and limited public investment are likely to make 2010 a much more difficult year than 2009. The low price of rice set by the government to benefit urban consumers, equivalent to the price in 1984, along with the lack of incentives such as improved seeds and fertilizer, have deterred farmers from planting for the next harvest. Many will produce for their families but not much more. This phenomenon could cause rice shortages by September 2010. The government's intervention in the vanilla market also threatens to harm one of the country's main

export sectors. The political crisis, combined with an increase in lawlessness, corruption, and a stifling of competition by wealthy private interests, have tarnished the investment climate. The potential loss of AGOA benefits threatens the livelihood of some 100,000 people employed in the garment sector (whose wages feed at least 500,000 urban Malagasy). Although contributing only marginally to GDP, this activity adds significantly to social stability and is of high political import. Fiscal revenues are likely to be about one-third lower in 2010 than in 2009, due to the freeze of donor funding and the lack of new investment projects in the pipeline; thus, the government will be forced to maintain fiscal austerity (or follow the Zimbabwe hyperinflation model).
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